

Lessors of tangible personal property under true leases in Illinois are deemed end users of the property to be leased. As end users of tangible personal property located in Illinois, lessors owe Use Tax on their cost price of such property. See 86 Ill. Adm. Code 130.220. (This is a GIL).

May 17, 1999

Dear Xxxxx:

This letter is in response to your letter dated April 7, 1999. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120(b) and (c), enclosed.

In your letter, you have stated and made inquiry as follows:

COMPANY is a small ticket lessor of mainly office equipment such as copiers, fax machines, computer, telephone systems, etc.. Our average lease length is 42 months. I am writing this letter to request an official ruling from the department of revenue concerning our leasing business and the proper sales/use/retailers occupation tax treatment.

COMPANY understands that in Illinois lessors of equipment, under an operating lease transaction, are considered the users of the equipment and must pay a use tax on the purchase of the equipment. However, for leases that are considered a conditional sale (i.e. \$1 purchase option), the lessor can issue a resale certificate and should then collect retailers occupation tax with each lease payment.

Since the tax is levied on the lessor for operating leases, it is the understanding of COMPANY that many organizations' exempt status does not 'pass through' to the lessor and the lessor must still pay tax when they purchase the equipment. It is common practice in the leasing industry to then pass a corresponding amount on to the lessee, thus in reality, the exempt organization is taxed. However, since conditional sales contracts are considered sales, the lessor issues a resale certificate to the vendor and the lessee can issue their exemption certificate to the lessor thus avoiding tax on the entire transaction. COMPANY realizes that there are certain exemptions that do apply to leasing (i.e. municipalities, government, certain hospital equipment, etc.). However, the customers we are most concerned about are other customers with exemption numbers such as churches, schools, hospitals (non-communication equipment), and other non-profits.

It is generally accepted that a lease with a \$1 purchase option (bargain purchase) is considered a sale, and a lease with a 10% fixed purchase option (FPO) is considered an operating lease. However, it has come to our attention that many of our competitors are using a 10% FPO and considering those leases to be conditional sales and granting

exemptions to all exempt organizations. Again, the equipment we are dealing with is mainly office equipment.

COMPANY respectfully requests a ruling to the following questions. Are leases with a 10% FPO considered conditional sales where an exemption can be granted to all exempt customers? Are leases with an FPO of less than 10% (i.e. 9%) considered conditional sales where an exemption can be granted to all exempt customers? If the answer is no, would the answer change if we are dealing with equipment with a longer useful life? Again, if the answer is no, are there any ways a lease could be structured with a 10% FPO and also be exempt for these exempt customers?

If you have any questions please call me at ####.

General Leasing Information

The following information generally discusses taxation of leases in Illinois. Please note that the State of Illinois taxes leases differently for Retailers' Occupation Tax and Use Tax purposes than the majority of other states. For Illinois sales tax purposes, there are two types of leasing situations: conditional sales and true leases.

A conditional sale is usually characterized by a nominal or one dollar purchase option at the close of the lease term. Stated otherwise, if lessors are guaranteed at the time of the lease that the leased property will be sold, this transaction is considered to be a conditional sale at the outset of the transaction, thus making all receipts subject to Retailers' Occupation Tax.

A true lease generally has no buy out provision at the close of the lease. If a buy out provision does exist, it must be a fair market value buy out option in order to maintain the character of the true lease. Lessors of tangible personal property under true leases in Illinois are deemed end users of the property to be leased. See the enclosed copy of 86 Ill. Adm. Code 130.220. As end users of tangible personal property located in Illinois, lessors owe Use Tax on their cost price of such property. The State of Illinois imposes no tax on rental receipts. Consequently, lessees incur no tax liability.

The above guidelines are applicable to all true leases of tangible personal property in Illinois except for automobiles leased under terms of one year or less, which are subject to the Automobile Renting Occupation and Use Tax found at 35 ILCS 155/1 et seq.

As stated above, in the case of a true lease, the lessors of the property being used in Illinois would be the parties with Use Tax obligations. The lessors would either pay their suppliers, if their suppliers were registered to collect Use Tax, or would self-assess and remit the tax to the Department. If the lessors already paid taxes in another state with respect to the acquisition of the tangible personal property, they would be exempt from Use Tax to the

extent of the amount of such tax properly due and paid in such other state. See 86 Ill. Adm. Code 150.310(a)(3) enclosed.

Under Illinois law, lessors may not "pass through" their tax obligation on to the lessees as taxes. However, lessors and lessees may make private contractual arrangements for a reimbursement of the tax to be paid by the lessees. If lessors and lessees have made private agreements where lessees agree to reimburse lessors for the amount of the tax paid, then lessees are obligated to fulfill the terms of the private contractual agreements.

Leasing, Conditional Sales and Exempt Organizations

Organizations that make application to the Department and are determined to be exclusively religious, educational, or charitable, receive an exemption identification number (an "E" number). See the enclosed copy of 86 Ill. Adm. Code 130.2007. This number evidences that this State recognizes that the organization is exempt from incurring Use Tax when purchasing tangible personal property in furtherance of its organizational purpose. Sales to a governmental body are subject to tax unless the governmental body has an active E number. See the enclosed copy of 86 Ill. Adm. Code 130.2080. If an organization or governmental body does not have an E number, then its purchases are subject to tax. Please be aware that only sales to the organization or governmental body holding the E number are exempt, not sales to individual members of the organization. Sales to such exempt organizations are not subject to Retailers' Occupation Tax liability as long as the retailer's books and records reflect that the purchase had a valid E number at the time of purchase.

As a general proposition, lessors who execute true leases with lessees exempt from paying sales tax on purchases of tangible personal property for their own use (e.g. exclusively religious, charitable or educational organizations or units of government) receive no pass through treatment and lessors owe Use Tax on their cost price of the rental property. The Use Tax burden remains on the lessor notwithstanding the status of the lessee. See *Continental Illinois Leasing Corp. v. Department of Revenue*, 108 Ill. App.3d 583 (First Dist., 1982).

Please be informed that recent legislation creates some limited exceptions to the general rule prohibiting pass through treatment. There can be an exemption from Retailers' Occupation Tax for sales of tangible personal property to lessors who lease that property to governmental bodies. In order to qualify for the exemption, there are three conditions that must be met. They are as follows:

1. The tangible personal property must be purchased for lease to governmental bodies under leases that have been executed or are in effect at the time of purchase;
2. The leases must be for a period of one year or longer; and
3. The leases must be to governmental bodies that have active tax exemption identification numbers issued by the Department under Section 1g of the Retailers' Occupation Tax Act.

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This exemption is not available for leases to governmental bodies under lease terms of less than one year. Please see 86 Ill. Adm. Code 130.2012 and 150.332, enclosed.

Also, the sale of computers and communications equipment and equipment used in the diagnosis, analysis, or treatment of hospital patients may be exempt when sold to lessors for use in satisfying already executed leases for periods of one year or longer with hospitals to whom the Department has issued a tax exemption identification number. For further information see 86 Ill. Adm. Code 130.2011 and 150.331, enclosed.

As stated above, the alternative to a true lease is a conditional sale. In Illinois, a conditional sale is usually characterized by a nominal purchase option at the close of the lease term. If the purchase option amounts to the fair market value of the tangible personal property, then the agreement would generally be considered to be a true lease. If the lessor/retailer is guaranteed that the item of tangible personal property is going to be sold at the end of the lease term, then the agreement is generally a conditional sale. This type of transaction is considered a conditional sale at the outset of the transaction making all receipts subject to Retailers' Occupation Tax. See Section 130.2010. In this situation, lessors/retailers may give Certificates of Resale to their suppliers for tangible personal property transferred subject to a conditional sales agreement. The lessors/retailers owe Retailers' Occupation Tax on any installment payments when they are received by the lessors/retailers. The lessees/purchasers owe corresponding Use Tax on the amount of the installment payments that are collected by the lessors/retailers. Exempt charitable, religious, educational, or governmental organizations may use their tax-exempt status in a conditional sales transaction as they would in any other retail purchases.

I hope this information is helpful. The Department of Revenue maintains a Web site, which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b).

Very truly yours,

Melanie A. Jarvis
Associate Counsel

MAJ:msk
Enc.